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No. 84-

IN THE

Supreme Court of the United States

October Term, 1984

WACHOVIA BANK AND TRUST COMPANY, N.A.,
Petitioner,

-vs.-

WILLIAM K. BANISTER,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Dated: September 8, 1984

QUESTIONS PRESENTED FOR REVIEW

1. Whether the Court of Appeals improvidently ruled that a security agreement must require a debtor to segregate the proceeds of a sale of collateral if the secured party wishes to seek non-dischargeability under §17(a)(2) of the Bankruptcy Act [1](now re-codified at §523(a)(6) of the Bankruptcy Code[2]) for the debtor's conversion or misappropriation of the proceeds.

2. Whether the Court of Appeals improvidently ruled that a secured party may not seek non-dischargeability under §17(a)(4) of the Bankruptcy Act (now re-codified at §523(a)(4) of the Bankruptcy Code) for a corporate officer's misappropriation of proceeds from the sale of collateral unless he personally benefited from the funds.

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1. 30 Stat 55, § 17 (1898) as amended 84 Stat 992, §35 (1970).

2. 93 Stat 387, § 523 (1978).

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IN THE

Supreme Court of the United States

October Term, 1984

WACHOVIA BANK AND TRUST COMPANY, N.A.,
Petitioner,

-vs.-

WILLIAM K. BANISTER,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is not yet reported. It is reproduced in the Appendix at A1-A10. Neither the Opinion of the Federal District Court, for the Northern District of New York, nor the Opinion of the Bankruptcy Court, for the Northern District of New York were officially reported. They are reproduced, however, at pp. A11-A18 and A19-A31 of the Appendix.

JURISDICTION

The Memorandum-Decision and Opinion of the Court of Appeals for the Second Circuit was rendered on June 13, 1984. This case arose under the Bankruptcy Act of 1898, as amended, 11 U.S.C. §35 (repealed) and the Bankruptcy Reform Act of 1978, 11 U.S.C. §523. This Court has jurisdiction pursuant to 28 U.S.C. §1254(1) and 2101(c).

STATUTORY PROVISIONS INVOLVED

The statutory provisions at issue are contained at former 11 U.S.C. §35 (repealed) and 11 U.S.C. §523. Pertinent portions of these statutes are reproduced *infra*.

STATEMENT OF CASE

The Second Circuit Court of Appeals held that a security agreement must require a debtor to segregate the proceeds of floor-planned inventory sales into a special segregated account, if the secured party wished to hold a debtor's conversion or misappropriation non-dischargeable under §17 of the Bankruptcy Act. As such, this opinion drastically alters the law of non-dischargeability as enacted by Congress, interpreted by the Courts and relied upon by the Credit Industry. Further, the holding is in conflict of the provisions of the security agreement at issue in this case.

This Adversary Proceeding was commenced by Wachovia Bank and Trust Co., N.A. ("Wachovia") in

August of 1974 in the United States Bankruptcy Court for the Northern District of New York. The Complaint sought to bar from discharge certain of the debts due and owing Wachovia by William K. Banister ("Banister"), the president of Northern Yachts, Inc. ("Northern").[3] Northern was located in Henderson Harbor, New York. Wachovia provided wholesale financing for Northern for its inventory of luxury yachts. Specifically, the plaintiff sought to bar from discharge the proceeds Banister received from the sales of two floor planned boats. Banister failed to remit these sums to Wachovia pursuant to the trust provisions of the financing agreements between the two parties. Banister converted the proceeds, and Wachovia sought judgment in the amount of $318,049, together with a declaration that the debt was excepted from discharge pursuant to §17 of the Bankruptcy Act.

The Bankruptcy Court conducted a hearing on this matter in December of 1980. By Memorandum-Decision and Order (Appendix pp. A19-A31) dated February 11, 1982, the Court held that Banister was liable to Wachovia in the amount of $318,049. Further, the Court held that this debt was non-dischargeable pursuant to §17(a)(2) and (a)(4)[4] of the Bankruptcy Act, for Banister's willful conversion and misappropriation

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3. Wachovia assigned any and all rights against Northern and Banister which arose out of the floor plan arrangement to Hatteras Yachts, a division of A.M.F. Inc., on December 17, 1974. As such, Wachovia was determined to be the real party in interest pursuant to FRCP 25(c) (See Appendix pp. A18, A24 and A31)

4. Section 17(a) provides, in pertinent part, that:

> A discharge in bankruptcy shall release a bankrupt from all of his provable debts . . . except such as (2) are liabilities . . . for willful and malicious conversions of the property of another; . . . [or] (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity.

of the proceeds. The debtor appealed to the federal district court for the Northern District of New York. Chief Judge Howard Munson affirmed the findings of the Bankruptcy Court in a Memorandum-Decision and Order (Appendix pp. A11-A18), dated May 24, 1983.

The Second Circuit Court of Appeals reversed the holdings of the lower courts in its Opinion (Appendix pp. A1-A10) dated June 13, 1984 (Newman, J.). The Court held that the debt was dischargeable, and that Wachovia failed to esablish that Banister had committed a conversion, or misappropriation of the funds under §17(a)(2) or (a)(4).

A. Material Facts

Banister received a franchise for Hatteras Yachts during the early 1970's. He sought financing for his new line of inventory through Wachovia. In order to receive this financing Banister executed a Floor Plam Agreement which gave Wachovia a purchase-money security interest in the boats financed, and provided, in pertinent part, that:

> II. FINANCING TRANSACTIONS: We hereby agree as follows: . . . (a) to notify you, prior to our receipt of any inventory which we desire to have financed hereunder, of the facts with respect thereto and that amount and nature of the Advance desired . . .
>
> (k) notwithstanding anything to the contrary contained in any trust receipt, promissory note, or other instrument given by us to you hereunder, *in the event any Inventory is sold, we will remit to you the Unpaid Balance of the Cost Price of each item of Inventory promptly upon the sale*

> *of each such item.* Any security in Inventory given to you will secure the payment of all obligations owed by us now or hereinafter. (Emphasis added.)

Pursuant to floor plan agreement, Banister executed a Note and Security Agreement for each boat he financed through Wachovia. The Note and Security Agreement outlined Northern's obligations, in pertinent part, as follows:

> If the Property described herein is held by the undersigned as "Inventory", the undersigned agrees to care for and hold such property only for the purpose of sale at retail and agrees further:. . . (II) *that in the event of sale of any item of property or other disposition thereof, the undersigned will pay promptly to Wachovia the amount due upon each item described,* (III) that the undersigned will keep any and all property, in whatever form same may be at any time or times, *separate and capable of identification as the property of Wachovia and will surrender and account therefor to Wachovia forthwith upon demand* and (IV) that all provisions of any underlying FLOOR PLAN AGREEMENT between the undersigned and Wachovia, not inconsistent with anything contained herein, shall be considered as a part of this document, as if fully set out herein . . . (Emphasis added.)

This language obligated Northern to hold whatever proceeds were received upon the sale of the Hatteras yacht, including cash, the "trade in" boat and its proceeds, *"in trust"* for Wachovia. Banister, as president of Northern, owed a fiduciary duty to Wachovia to see that the legal obligations of Northern were met. This trust relationship was essential to ensuring Wachovia that the large sums of money loaned to Northern would be promptly repaid upon each commercial sale.

The unrebutted evidence presented at the 1980 hearing established that Banister failed to remit the proceeds, consisting of cash and two "trade-in" boats, from the sale of two Hatteras yachts in 1973. Wachovia advanced the funds to finance these yachts, and Banister's failure to remit the proceeds to Wachovia was in violation of the provisions of the Note and Security Agreement. Banister deliberately concealed the sales to Wachovia's representatives, thus undermining the delicate balance of trust that must exist between a secured party and its debtor.

Ultimately, Banister's creditors filed an involuntary petition in Bankruptcy against Northern on January 30, 1974. Banister and his wife, Betsy, filed personal petitions for discharge on March 22, 1974. This action ensued.

REASONS FOR GRANTING THE WRIT

Although the Bankruptcy Act has been replaced by the new Code, the provisions at issue on this appeal have been re-codified and appear at 11 USC §523.[5] Section 523(a)(4) is essentially a restatement of former §17(a)(4) as amended in 1970. Section 523(a)(6) provides that a debt is non-dischargeable if it arises from a "willful and malicious injury" by the debtor. Former §17(a)(2) had provided for non-dischargeability where the debt was the result of a "willful and malicious conversion". Both the legislative history of the

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5. Section 523(a) of the Bankruptcy code provides, in part, that:

> A discharge under Section 727, 1141 or 1328(b) of this title does not discharge an individual from any debt -
> (4) for fraud or defalcation while acting in a fiduciary capacity - embezzlement or larceny; . . . (6) for willful and malicious injury by the debtor to another entity, or to the property of another entity.

Bankruptcy Reform Act [(P.L. 95-598), Statement of Rep. Don Edwards (September 28, 1978), 124 Cong. Rec. H11089, 1978 U.S. Code Cong. Ad. News 6436, 6454; Statement of Senator Dennis DeConceni (October 6, 1978), 124 Cong. Rec. S17406, 1978 U.S. Code Cong. Ad. News 6505, 6523], and interpretative case law, [*Bombardier Corp. v. Penning, (In re Penning),* 22 B.R. 616, 618 (Bankr. E.D. Mich. 1982); *Pioneer Bank & Trust Co. v. Scotella, (In re Scotella),* 18 B.R. 975, 976 (Bankr. N.D. Ill. 1982); *Evereud v. Ayers, (In re Ayers),* 25 B.R. 762, 778 (Bankr. M.D. Tenn. 1982); *Hines v. Tanner, (In re Tanner),* 17 B.R. 201, 203 (Bankr. W.D. Ky. 1982); *Borg Warner Acceptance Corp. v. Simmons, (In re Simmons),* 9 B.R. 62, 65 (Bankr. S.D. Fla. (1980)], have held that §523(a)(6) includes non-dischargeability for a willful and malicious conversion of the property of another.

Courts interpreting §523(a)(6) and (a)(4) have sought guidance from earlier decisions under §17(a)(2) and (a)(4). A ruling by this Court would serve to clarify an important and recurring issue under the new Bankruptcy Code. Further, the financial transaction at issue in this case is typical of the multitude of trust arrangements between secured parties and debtors that affect interstate commerce. A secured party who enters into a floor planning arrangement, similar to the one existing in this case, must rely upon the integrity of the debtor to repay the loan with proceeds of inventory sales. This delicate relationship is undermined when the debtor is allowed to sell his inventory, convert the proceeds to unauthorized use and have this debt discharged in bankruptcy.

Large amounts of capital are entrusted to floor plan debtors in the marketplace to finance the sales of a host of consumer items (motor vehicles, furniture, appliances, etc.). Floor plan financing assists rapid movement of these items from manufacturers to consumers. The Credit Industry risks losing a great

deal of money in a very short period of time through this type of financing. If debtors such as Banister are granted bankruptcy discharges for undermining this trust relationship, the Credit Industry will undoubtedly re-evaluate the nature of this financing, to the potential harm of established lines of commerce.

I

THE COURT OF APPEALS INCORRECTLY RULED THAT THE FAILURE TO REMIT PROCEEDS FROM OUT OF TRUST SALES WAS NOT A CONVERSION UNDER §17(a)(2)

The Court of Appeals held that Banister's failure to remit the proceeds of the out of trust sales did not amount to a conversion under §17(a)(2). The Court held that neither the Floor Plan Agreement nor the Note and Security Agreement required Banister to hold the proceeds separate and apart or to remit "specific money" to Wachovia. As such, the Court held that Banister did not convert the sale proceeds of the two boats when he converted them to other purposes, and his debt for the default on the notes was dischargeable.

Initially, the petitioner asserts that the Court below erred as a matter of fact. The Floor Plan Agreement and Note and Security Agreement require the debtor to promptly remit the proceeds of sale of a floor planned boat. Additionally, the Note and Security Agreement required Banister to keep the inventory and cash or trade-in proceeds *separate and capable of identification.* This is precisely the standard imposed by the Court of Appeals. The Court misread the plain meaning of the contractual language and found that the provision

only required that the *inventory* was to be held separate and capable of identification. The inventory, however, consisted of yachts in excess of 50 feet in length. Their sheer size made them easily capable of identification. The holding, then, is clearly erroneous.

Regardless of the Court's mistaken interpretation of the facts, it incorrectly held, as a matter of law, that the debtor did not commit a conversion under §17(a)(2). This Court has long recognized the importance of the financing at issue in this litigation. *See e.g. Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934).[6] In *Davis* this Court held that an out of trust sale of inventory was a conversion under §17(a)(2), but found, based on the facts of the case, that the conversion was not "willful and malicious". [7]

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6. The Court of Appeals opinion (Appendix p. A7) recites that the Note and Security Agreement could not require Banister to transfer title to the property or proceeds to Wachovia, and cites *Davis* for that proposition. This Court in *Davis*, however, specifically stated that it was not rendering a holding on the conversion of proceeds to the collateral. That issue, apparently, had not been raised before the Court. (293 U.S. at 344-5) Wachovia has, quite clearly, asserted throughout this litigation that it was entitled to the *proceeds*.

7. The Second Circuit did not render a decision as to whether Banister's actions were willful and malicious because it found there was no conversion. (Appendix p. A5) However, this Court has long recognized that § 17(a)(2) is applicable to bar discharge to a debtor who acts in knowing disregard of a duty. *Tinker v. Colwell*, 193 U.S. 473, 486 (1904). *Tinker* is clearly applicable to the facts of this case under § 17 (a)(2). Banister knew full well what his duties were under the trust agreements when he misappropriated the proceeds. An issue has been raised, however, as to the applicability of *Tinker* to the Bankruptcy Reform Act, *See* H.R. Rep. 595, 95th Cong. 2d Sess. pp. 365, 366 but the case is clearly on point under the Bankruptcy Act.

In re-codifying §17(a)(2), Congress expressed its intent to preserve as non-dischargeable:

> . . . a conversion under which the debtor willfully and maliciously intends to borrow property for a short period of time with no intent to inflict injury but on which injury is in fact inflicted.

H.R. Rep. 95-595, p. 364, 1978, U.S. Code Cong. Ad. News, p. 6320. This theme has guided the overwhelming number of courts that have found that such out of trust sales of inventory, and attendant misappropriation of proceeds, represents a conversion within the meaning of §§17(a)(2) and 523(a)(6). *Cardell Enterprises Corp. v. Armeni (In re Armeni),* 32 B.R. 81, 82 (Bankr. S.D. Fla. 1983); *Wisconson Finance Corp. v. Ries (In re Ries),* 22 B.R. 343, 346 (Bankr. W.D. Wis. 1982); *Pioneer Bank & Trust Co. v. Scotella (In re Scotella),* 18 B.R. 975, 976 (Bankr. N.D. Ill. 1982); *Trust Co. Bank v. Ricketts (In re Ricketts),* 16 B.R. 833, 834 (Bankr. N.D. Ga. 1982); *Menely Motors Inc. v. Giantvelly (In re Giantvelly),* 14 B.R. 457, 458 (Bankr. D. Nev. 1981); *First National Bank v. Duranti (In re Duranti),* 5 BCD 841, 842 (Bankr. W.D. Wis. 1979). The main theme expressed by these decisions is that a non-dischargeable conversion occurs under §§17(a)(2) or 523(a)(6), where a debtor places collateral out of reach of the secured party, and misappropriates the proceeds to other uses. This scenario has been viewed as a "classical conversion" under federal bankruptcy law. Further, these Courts did not demand a special segregation of proceeds in light of the debtor's obvious duty to his creditors.

Banister's failure to remit proceeds from the sale of Wachovia's collateral represents a classical conversion under §17(a)(2), §523(a)(6) and interpretative case law. The Second Circuit's opinion, requiring a specially segregated proceeds account, is contrary to the clear

weight of federal authority interpreting "conversion" as that term has been defined by Congress in §§17(a)(2) and 523(a)(6). Further, the Court's ruling is contrary to the basis of the trust relationship that actually exists between secured parties and their debtors.

The authority for the Court of Appeal's ruling that a security agreement must require a debtor to specially segregate the proceeds from sales of the collateral is based on a faulty interpretation of New York State law. The court cited a lower New York State court opinion, *Independent Discount Corp. v. Bressner,* 47 A.D.2d 756 (2d Dept. 1975), for the proposition that a conversion does not occur unless the security agreement requires segregation of specific funds. This unusual case, however, mistakenly relied upon a 1920 New York Court of Appeals decision, *Hinkle Iron Co. v. Kohn,* 299 N.Y. 179, 182-3 (1920). In *Hinkle,* the plaintiff sought recovery for a pre-contract remittance which had been placed in escrow pending defendant's completion of a construction contract. The defendant, however, invaded the escrow account, spent the funds and declared bankruptcy without completing the contract. The Court held that the transfer was an "equitable assignment" in which the plaintiff retained legal ownership over this specific escrow account. (229 N.Y. at 183) The facts of *Hinkle* bear little resemblance to the case at hand, and the Court of Appeal's reliance upon it was mistaken. [8]

The tort of conversion is committed under New York State law where one party exercises unauthorized assumption of the right of ownership or possession

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8. The Court of Appeals also cited *Hinkle* with approval for the proposition that a security agreement must require a debtor to turn over the proceeds of a designated fund (Appendix p. A7), but as has been shown this case is inapposite to the facts presented herein.

to the exclusion of a party who has a superior right to ownership or possession of the property in question. *Employer's Fire Insurance Co. v. Colton,* 245 N.Y. 102, 104 (1927); *Meese v. Miller,* 79 A.D.2d 237, 242 (4th Dept. 1981); *Bunge Corp. v. Manufacturer's Hanover,* 37 A.D.2d 409, 414 (1st Dept. 1971); *First National Bank of Highland v. Merchant's Mutual Ins. Co.,* 89 Misc.2d 771, 774 (S.Ct. Ulster Co. 1977). A secured party has such a superior interest to the collateral and its proceeds and may maintain an action for conversion. *Gandy v. Collins,* 214 N.Y. 293, 297-8 (1915); *McInode v. Ithaca Loan Finance Co.,* 24 A.D.2d 802 (3d Dept. 1965). In *Gandy* Judge Cardozo held that a bank which held a mortgage in personal property had a superior interest in that property over the debtor or its assigns. *(Gandy, supra)*

The undisputed facts presented in the Courts below established that Wachovia held a valid security interest in the floor planned boats. As such, its interest in the boats, and their proceeds, was superior to that of Banister. Wachovia could have maintained a common law action in conversion against Banister under New York State law. To the extent that the Court of Appeals relied upon New York law for its holding, this reliance was misplaced.

II

THE COURT OF APPEALS INCORRECTLY RULED THAT THE FAILURE TO REMIT PROCEEDS FROM OUT OF TRUST SALES WAS NOT A MISAPPROPRIATION UNDER §17(a)(4)

The Court of Appeals reversed the lower courts' holdings that Banister had misappropriated the proceeds pursuant to §17(a)(4) of the Bankruptcy Act (See Appendix pp. A8-A10). The Court's reasoning was

twofold: 1) there was no showing of an express obligation by Northern to turn over the specific proceeds in question and 2) there was no evidence that the proceeds were diverted to Banister's personal use. The petitioner contends that case law does not require the trust relationship demanded by the Second Circuit (See Point I), nor does it require a showing that funds were used for the personal benefit of the debtor.

Courts interpreting §17(a)(4) and §523(a)(4) have held that a corporate officer may not be personally discharged for a debt that arises from his misappropriation of proceeds from sales of collateral, for which the corporation was liable. *John P. Maguire & Co. v. Herzog,* 421 F.2d 419, 422 (5th Cir. 1970) (floor planned furniture); *Bombardier Corp. v. Penning (In re Penning),* 22 B.R. 616, 619-20 (Bankr. E.D. Mich. 1982) (floor planned snowmobiles); *Thomas Motors Inc. v. Newman (In re Newman),* 2 BCD 894, 896 (Bankr. S.D.N.Y. 1976) (floor planned automobiles). Additionally, courts have not required the secured party to establish that the funds were misappropriated for the debtor's personal use, as long as there is a showing of misappropriation. *Pan American World Airways v. Follard (In re Follard),* 10 B.R. 875, 876 (D. Md. 1981); *Kaufman v. Lederfine,* 49 F.Supp. 144, 145 (S.D.N.Y. 1943); *Thomas Motors Inc. v. Newman (In re Newman), supra.*

The Bankruptcy Court held that Banister, as president and sole stockholder of Northern, diverted proceeds from floor plan sales to other purposes (Appendix p. A28). As such, this misappropriation was non-dischargeable under §17(a)(4), and the decision of the Court of Appeals should be reversed.

CONCLUSION

For the foregoing reasons the petition for writ of certiorari should be granted.

Respectfully submitted,

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Dated: September 8, 1984

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 934—August Term, 1983

Argued: March 21, 1984 Decided: June 13, 1984

Docket No. 83-5031

In the Matter of:

WILLIAM K. BANISTER,

Bankrupt.

WACHOVIA BANK AND TRUST COMPANY, N.A.,

Plaintiff-Appellee,

—v.—

WILLIAM K. BANISTER,

Defendant-Appellant.

Before:

KAUFMAN, NEWMAN, and PRATT,

Circuit Judges.

Appeal from a judgment of the District Court for the Northern District of New York (Howard G. Munson, Chief Judge) affirming an order of Bankruptcy Judge Justin Mahoney, entered under the 1898 Act, that a debt allegedly arising from diversion of proceeds of inventory sold pursuant to a floor plan agreement was not dischargable.

Reversed.

ROBERT B. SHAAD, Watertown, N.Y., *for defendant-appellant.*

RICHARD W. COOK, Syracuse, N.Y. (Bruce G. Soden, Thomas C. Buckel, Jr., Syracuse, N.Y., on the brief), *for plaintiff-appellee.*

JON O. NEWMAN, *Circuit Judge*:

The principal issue on this appeal is whether a corporate officer who fails to disburse to a secured creditor proceeds from the sale of inventory in which the creditor has a secured interest incurs a debt that is non-dischargeable in the personal bankruptcy of the officer. Defendant-appellant William K. Banister appeals from a judgment of the District Court for the Northern District of New York (Howard G. Munson, Chief Judge) affirming a decision of Bankruptcy Judge Justin Mahoney. The judgment against Banister in favor of plaintiff-appellee Wachovia Bank and Trust Co., N.A. ("Wachovia") for $318,049 declares that the debt is non-dischargeable un-

der sections 17a(2) and (4) of the Bankruptcy Act of 1898, as amended ("the Act"). Because we conclude that, under the circumstances disclosed by the record, a non-dischargeable debt was not incurred, we reverse.

Banister was president and sole stockholder of Northern Yachts, Inc. of Henderson Harbor, New York, a franchised dealer for the Hatteras Yacht Company ("Hatteras") of North Carolina. To finance the purchase of Hatteras yachts as inventory for ultimate resale to customers, Northern Yachts entered into a floor plan agreement with Wachovia, a North Carolina bank. The agreement contemplated the execution of a promissory note and security agreement for each yacht financed. The arrangement enabled Northern Yachts to acquire inventory by paying only 10% cash, with the bank financing the remaining 90%. The floor plan agreement obligated Northern Yachts to remit to the bank the unpaid balance of each item of inventory promptly upon its sale. The note and security agreement, executed for each yacht financed, provided that, "[t]o secure the payment of the note," Northern Yachts transfers to Wachovia the yacht "together with all proceeds therefrom."

The dispute on this appeal arises from the sale of two yachts by Northern Yachts to its customers in the summer of 1973. Wachovia had financed Northern Yacht's purchase of these two yachts from Hatteras and had received notes totaling $318,049. Each yacht was sold for cash plus a trade-in, neither of which was turned over to Wachovia. In the fall of 1973, Banister and his wife agreed to guarantee the debts of Northern Yachts to Wachovia up to the amount of $500,000. An involuntary petition in bankruptcy was filed against Northern Yachts in January 1974, and it was adjudicated a bankrupt in April 1974. Banister and his wife filed voluntary bankruptcy petitions in March 1974.

In August 1974 Wachovia filed its complaint against Banister in his personal bankruptcy proceeding. The complaint alleged that Banister had sold the two yachts, failed to remit the proceeds to the bank, and expended the proceeds "for other than satisfying the indebtedness evidenced by" the bank's notes. It also alleged that "by reason of the misappropriation of plaintiff's property while [Banister] was acting as an officer of Northern Yachts, Inc.," he became indebted to the bank in the amount of $318,049. Finally, the complaint sought a declaration that the debt was not dischargeable pursuant to section 17 of the Bankruptcy Act of 1898, as amended, 11 U.S.C. § 35 (1970) (now replaced by section 523 of the Bankruptcy Code, 11 U.S.C. § 523 (1982)). Banister denied the allegations of the complaint and interposed several defenses. The matter languished until 1980, when Judge Mahoney conducted a hearing on the complaint. In February 1982 he entered an order determining that Banister was indebted to Wachovia in the amount of $318,049 and that this debt was non-dischargeable under both sections 17(a)(2) and (4) of the Act.[1] That decision was affirmed by Chief Judge Munson in May 1983.

On appeal Banister raises a variety of issues, but our resolution of one—whether a non-dischargeable debt was incurred—is dispositive. Section 17(a)(2) of the Act makes non-dischargeable any debt resulting from "willful

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[1] The Bankruptcy Judge adjudicated not only dischargeability but also the existence of liability for the debt and its amount. We agree with Banister that if non-dischargeability had been correctly determined, he would have been entitled to a jury trial on the issues of liability and amount of indebtedness. *See In re Merrill*, 594 F.2d 1064, 1068 (5th Cir. 1979); *In re Copeland*, 412 F. Supp. 949, 954 (D. Del. 1976); *Transport Indemnity Co. v. Hofer Truck Sales*, 339 F. Supp. 247 (D. Kan. 1971); Countryman, *The New Dischargeability Law*, 45 Bankr. L.J. 1, 40-42 (1971); Countryman, *Jury Trials on Dischargeability—A Reply to Referee Herzog*, 46 Am. Bankr. L.J. 305 (1972).

and malicious conversion of the property of another." The Bankruptcy Judge ruled that a "conversion" had occurred because Northern Yachts did not turn over to Wachovia the proceeds of the sale of the two yachts. We disagree. Before determining whether Banister's conduct was sufficiently "willful and malicious" for purposes of the federal non-dischargeability standard, *see, e.g., Tinker v. Colwell*, 193 U.S. 473, 485-87 (1904), we must determine whether, at a minimum, Banister committed the tort of conversion under relevant state law.[2] Though the financing agreements provided that they were governed by the laws of North Carolina, we look to New York law in determining whether Banister's conduct there constituted a state law tort.[3] *See O'Rourke v. Eastern Air Lines, Inc.*, 730 F.2d 842, 846-51 (2d Cir. 1984).

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2 Having recognized that Banister would be entitled to a jury trial on the existence of liability for conversion, *see* note 1, *supra*, we nonetheless must review the correctness of the determination, for which the Bankruptcy Judge was the proper fact-finder, *see In re Merrill*, 594 F.2d 1064 (5th Cir. 1979); *In re Swope*, 466 F.2d 936 (7th Cir. 1972) (per curiam), *cert. denied*, 409 U.S. 1114 (1973); Countryman, *The New Dischargeability Law*, *supra*, 45 Am. Bankr. L.J. at 35-40; *but see In re Law Research Service, Inc.*, [1970-73 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 64,528 (Bankr. S.D.N.Y. Dec. 9, 1971); Herzog, *The Case for Jury Trials on the Issue of Dischargeability*, 46 Am. Bankr. L.J. 235 (1972), that a conversion sufficient to invoke section 17(a)(2) occurred. Even if our ruling on this point were adverse to Banister, he still would be entitled to avoid liability for conversion if he could successfully resist the creditor's efforts to persuade a jury that a state law tort of conversion had occurred. *See* Countryman, *The New Dischargeability Law*, *supra*, 45 Am. Bankr. L.J. at 41-42; Countryman, *Jury Trials on Dischargeability—A Reply to Referee Herzog*, *supra*, 46 Am. Bankr. L.J. at 308; *cf. Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 510-11 (1959) ("only under the most imperative circumstances . . . can the right to a jury trial of legal issues be lost through prior determination of equitable claims").

3 The choice of law provision in the financing agreements applies North Carolina law to "the contract." Neither party has urged the application of North Carolina law to the issue of tort liability; rather both have relied on New York law.

In the absence of a duty imposed upon Northern Yachts to segregate the proceeds and remit those very funds to Wachovia, Banister did not commit the tort of conversion by devoting the proceeds to the corporation's general business purposes, even though the corporation ultimately defaulted on its obligation to pay Wachovia the unpaid balance of the two promissory notes. *See Independence Discount Corp. v. Bressner*, 47 A.D.2d 756, 365 N.Y.S. 2d 44 (2d Dep't 1975). Whether the agreements created a duty to segregate the proceeds requires further consideration.

The floor plan agreement obligated Northern Yachts to remit "the Unpaid Balance of the Cost Price of each item of Inventory promptly upon the sale of each such item." Similarly, the note and security agreement required Northern Yachts, in the event of sale, to "pay promptly to Wachovia the amount due upon each item described." This obligation to pay "the balance" or "the amount due" stands in marked contrast to the language of the acceleration clause, which gave Wachovia the right to declare immediately due all amounts owing if Northern Yachts "fails to remit promptly any amounts received from any disposition of the property." The bank's security agreement gave it a right of acceleration in the event that "any amounts received" were not remitted, but imposed upon its debtor only an obligation to pay "the amount due." The distinction is assuredly a technical one, but a bank, drafting a form agreement that it hopes will create the basis for claiming, in the event of non-payment, the existence of a non-dischargeable debt, must select language that unmistakably creates an obligation to hold proceeds separate and to remit "*specific money*," *Independence Discount Corp. v. Bressner, supra*, 47 A.D.2d at 757, 365 N.Y.S.2d at 46 (emphasis in original);

cf. In re Simmons, 9 Bankr. 62, 64 (Bankr. S.D. Fla. 1981) (floor plan agreement required segregation of proceeds in separate trust account); *Hinkle Iron Co. v. Kohn*, 229 N.Y. 179, 128 N.E. 113 (1920) (debtor obliged to turn over portion of a "designated fund").

Nor does such an obligation arise from other clauses of Wachovia's financing agreements. The note and security agreement does include an obligation to "keep any and all property, in whatever form same may be at any time or times, separate and capable of identification as the property of Wachovia," but the context in which this obligation is expressed makes it clear that "property" refers to the listed items held as inventory and not to the proceeds from the sale of such items. The only reference to "proceeds" is the following clause: "To secure the payment of this note . . . the undersigned hereby transfers and conveys to Wachovia . . . the property . . . described below, together with all proceeds therefrom . . . ." As the Supreme Court observed with respect to a floor plan agreement for automobiles, "The trust receipt may state that the debtor holds the car as the property of the creditor; in truth it is his own property, subject to a lien." *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 334 (1934). The quoted language from Wachovia's agreement created a security interest in the proceeds, which would have existed in any event by virtue of section 9-306 of the Uniform Commercial Code, but did not create an express obligation to hold separate and remit the specific proceeds received upon a sale of an item of inventory. In *Independent Discount Corp. v. Bressner, supra*, the Appellate Division explicitly recognized that the creditor obtained a security interest in the proceeds of the inventory that had been sold, but nonetheless ruled that no conversion had occurred. That state law rule coincides

with our view of federal law that Wachovia, by achieving a secured interest in the proceeds that entitled it, upon compliance with U.C.C. § 9-306, to priority as against other creditors, did not thereby become entitled to pierce the barrier of a bankruptcy discharge. In the absence of a conversion under state law that would satisfy the first requirement of section 17(a)(2) of the Act, we do not reach the further federal law question of whether a conversion would have been "willful and malicious" within the meaning of this provision. *See* 3 *Collier on Bankruptcy* ¶ 523.16 at 523-129 n.37 (15th ed. 1984) ("Mere failure to pay over money received from sale of secured property does not show willfulness or maliciousness so as to constitute willful and malicious conversion."). We turn then to the Bankruptcy Judge's alternative ground for decision.

Section 17(a)(4) of the Act makes non-dischargeable a debt of the bankrupt "created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity." The Bankruptcy Judge recognized that the Supreme Court has limited the application of section 17(a)(4) to "technical trusts, and not those which the law implies from contract." *Chapman v. Forsyth*, 43 U.S. (2 How.) 202, 208 (1844); *see Davis v. Aetna Acceptance Co.*, *supra*, 293 U.S. at 333; *Upshur v. Briscoe*, 138 U.S. 365, 375-76 (1891); *Hennequin v. Clews*, 111 U.S. 676, 682 (1884). "It is not enough that by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee *ex maleficio*. He must have been a trustee before the wrong and without reference thereto." *Davis v. Aetna Acceptance Co.*, *supra*, 293 U.S. at 333. As we have ruled in rejecting non-dischargeability under section 17(a)(2), the financing agreements did not create an express obliga-

tion requiring Northern Yachts to hold in trust for Wachovia the specific proceeds of inventory sold.[4]

Nevertheless, the Bankruptcy Judge found a non-dischargeable debt under section 17(a)(4), relying on cases such as *John P. McGuire & Co. v. Herzog*, 421 F.2d 419 (5th Cir. 1970); *In re Hammond*, 98 F.2d 703 (2d Cir.), *cert. denied*, 305 U.S. 646 (1938); and *In re Bernard*, 87 F.2d 705 (2d Cir. 1937), for the proposition that misuse of funds in disregard of a known obligation constitutes fraud within the meaning of section 17(a)(4). The common denominator of those decisions, however, is that in each case the corporate officer found to have incurred a non-dischargeable debt by using corporate funds in breach of his fiduciary duty had used the money for his personal benefit. In *John P. McGuire & Co.*, the officer had used proceeds from the sale of floor plan inventory to pay creditors to whom he was secondarily liable, the Fifth Circuit expressly noting that section 17(a)(4) "has been applied when an officer of a corporation has misused his position to gain a personal benefit at the expense of the corporation or corporate creditors." 421 F.2d at 422. In *Hammond* a corporate director's liability to his corporation arose from his having profited from the purchase and sale of stock offered to his corporation. In *Bernard* the liability to the assignee of the corporation arose from the action of the director of an insolvent

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[4] In the absence of such a contractual obligation, we need not decide whether a trust-account obligation can convert a debtor-creditor relationship into a fiduciary relationship for purposes of section 17(a)(4) of the Act. *Compare In re Talcott*, 29 Bankr. 874, 878-79 (Bankr. D. Kan. 1983) (no fiduciary relationship); *In re Chambers*, 23 Bankr. 206, 208-09 (Bankr. W.D. Wis. 1982) (same); *In re Graham*, 7 Bankr. 5, 7 (Bankr. D. Nev. 1980) (same); *In re Miles*, 5 Bankr. 458 (Bankr. E.D. Va. 1980) (same), *with In re Simmons*, *supra*, 9 Bankr. at 64-65 (debtor becomes a fiduciary).

corporation in distributing corporate funds to himself and his son. In each case, the element of personal benefit was crucial to the holding of a breach of a fiduciary duty to the corporation sufficient to satisfy the requirements of section 17(a)(4). In the instant case, there is no evidence that Banister personally benefited from the proceeds of the sale of the two yachts, and the Bankruptcy Judge did not purport to find that such had occurred. Since Banister neither diverted specific corporate funds expressly required to be held segregated for the creditor's benefit, *see In re Folliard*, 10 Bankr. 875, 876 (Bankr. D. Md. 1981), nor personally benefited from the use of general corporate funds, he did not commit any fraud or misappropriation in a fiduciary capacity within the meaning of section 17(a)(4). *Cf. In re Whitlock*, 449 F. Supp. 1383 (W.D. Mo. 1978) (debt dischargeable that arose out of breach of implied trust in absence of personal gain; debt non-dischargeable that arose out of breach of express trust by virtue of preexisting agency relationship).

The judgment of the District Court is reversed.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

U. S. DISTRICT COURT
N. D. OF N. Y.
FILED
MAY 24 1983
AT ____ O'CLOCK ____ M.
J. R. SCULLY, Clerk
SYRACUSE

In re WILLIAM K. BANISTER,

Bankrupt.

WACHOVIA BANK AND TRUST COMPANY, N.A.,

Plaintiff-Respondent,

v.

82-CV-398

WILLIAM K. BANISTER,

Defendant-Appellant.

APPEARANCES:

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BRUCE G. SODEN, ESQ.
THOMAS C. BUCKEL, JR., ESQ.

HOWARD G. MUNSON, C.J.

MEMORANDUM-DECISION AND ORDER

This is an appeal from the Bankruptcy Court, Justin J. Mahoney, Bankruptcy Judge, declaring a $318,049.00 debt owing to plaintiff-respondent [Wachovia] to be non-dischargeable in bankruptcy. Judge Mahoney specifically found that defendant-appellant [Banister] violated Section 17)(a)(2) and

17(a)(4) of the Bankruptcy Act of 1898 by obtaining money through a willful and malicious conversion and through misappropriation in breach of a fiduciary duty. In a Memorandum-Decision and Order dated November 1, 1982, this Court affirmed a prior ruling by Judge Mahoney declaring a $75,000.00 debt of Banister's to be non-dischargeable under section 17(a)(2). See In re Banister, No. 81-CV-1059 (N.D.N.Y. Nov. 1, 1982).

William K. Banister was President and sole owner of Northern Yachts, Inc., a dealer of Hatteras and Bertram Yachts in Henderson Harbor, New York. As part of his financing arrangements, Banister entered into a floor planning agreement with Wachovia. Reduced to its most simple terms, Wachovia agreed to supply 90% of the financing for Banister's purchase of Hatteras Yachts. The yachts that Banister purchased under the agreement were to be kept in inventory as "floor models." In this manner, Banister could keep a large inventory of expensive yachts at his dealership while only putting 10% of the purchase price down with the manufacturer. Pursuant to the agreement, when boats held by Banister as "inventory" were sold, the proceeds were to be remitted to Wachovia.

In the instant case, Wachovia alleges that Banister sold two boats out of inventory and failed to remit the proceeds pursuant to the floor planning agreement. Banister is alleged to have lied to various persons about the location of the boats and is

subsequently alleged to have admitted that he sold the boats and did not have the money to pay back Wachovia. With respect to this allegation, Wachovia's complaint in the Bankruptcy Court stated the following:

> 6. Upon information and belief that subsequent thereto the defendant as President of Northern Yachts, Inc. did cause each of the aforesaid boats to be sold to retail customers for sums in excess of respective balances due and owing upon the aforesaid notes and security agreements and did receive the proceeds of said sale.
>
> 7. Upon information and belief that the defendant upon receipt of such proceeds did expend such proceeds for purposes other than satisfying the indebtedness evidenced by the aforesaid notes and security agreements.
>
> 8. That as a result of the facts aforesaid defendant became indebted to plaintiff by reason of misappropriation of plaintiff's property while the said defendant was acting as an officer of Northern Yachts, Inc. and is in fact indebted to plaintiff in the amount of $318,049.00.

Complaint ¶¶ 6-8. Banister raised six affirmative defenses to the complaint and a trial on the merits was held in Albany, New York on December 11-12, 1980. The Court will treat Banister's various grounds for appeal seriatim.

Right to a Jury Trial

Banister made a timely demand for a jury trial on all of the issues raised in the Wachovia complaint. At one point counsel for Banister expressed his willingness to waive a jury trial if

the proceeding could be held in Watertown, New York. However, this agreement never came about and Banister still pressed his demand for a jury trial.

The question of whether a debtor is entitled to a jury trial in a non-dischargeability proceeding has generated much controversy. While there is some limited authority to indicate that the 1970 amendments to the Bankruptcy Act mandate jury trials, see In re Law Research Service, Inc., No. 71-E-598 (Bankr. S.D.N.Y. Dec. 9, 1971), the overwhelming weight of authority supports Judge Mahoney's decision not to grant Banister a jury trial. See, e.g., In re Swope, 466 F.2d 936 (7th Cir. 1972)(per curiam), cert. denied, 409 U.S. 1114 (1973); In re Merrill, 433 F. Supp. 455 (N.D. Ala. 1977); In re Copeland, 412 F. Supp. 949 (D. Del. 1976); In re Sneider, 59 F.R.D. 391 (S.D.N.Y. 1973); In re Hinchey, 349 F. Supp. 116 (D. Or. 1972); In re Palfy, 336 F. Supp. 1269 (N.D. Ohio 1972). This result is also supported by the commentators. See Countryman, The Dischargeability Law, 45 Am. Bankr. L.J. 35 (1971); 1A Collier on Bankruptcy, ¶ 17.28A[6] (14th ed. 1976).

Banister cites one principal case, Transport Indemnity Co. v. Hofer Truck Sales, 339 F. Supp. 247 (D. Kan. 1971), for his view that Judge Mahoney wrongfully denied him a jury trial. A close reading of the Transport Indemnity case shows that Banister's reliance is misplaced. The court in Transport

Indemnity clearly recognized that there is no right to a jury trial in a dischargeability case, instead holding that where there is also a question of tort liability of the parties to each other, a jury trial should not necessarily be denied. Id. at 248. In the case at bar, there were no counterclaims to be adjudicated by a trier of fact. Thus, the Transport Indemnity case is clearly distinguishable. Banister's assertion of error in this regard is hereby rejected.

Failure to Demand a Money Judgment

In Banister's view, the failure of the Wachovia complaint to include a demand for a money judgment constitutes a jurisdictional defect. This Court finds such objection to be without merit. The "wherefore" clause of Wachovia's complaint asks for an order of the Bankruptcy Court

> pursuant to Section 17 of the Bankruptcy Act that the aforesaid indebtedness on the part of the defendant to plaintiff shall not be discharged in this proceeding and that such indebtedness shall remain in full force and effect on the part of the defendant to the plaintiff subsequent to this proceeding.

While Banister is technically correct that the complaint does not by its terms mention a specific monetary demand, it is clear that Wachovia was referring to paragraph 8 of the complaint which stated that defendant was indebted to plaintiff in the amount of $318,049.00. The "wherefore" clause, and, for that matter, the

entire complaint, is drafted with the goal of obtaining an order of non-dischargeability. Accordingly, plaintiff's claim of a jurisdictional defect must fail.

Failure of Wachovia to Meet its Burden of Proof

In two separate points on appeal, Banister argues that Wachovia failed to properly plead and prove its cause of action. First, Banister claims that the pleadings do not state a cause of action under section 17(a)(2) and, therefore, the Bankruptcy Court erred by finding that Banister had willfully and maliciously converted funds. As Judge Mahoney correctly pointed out, the question of whether section 17(a)(2) or 17(a)(4) applies is one of law. Wachovia made a very broad and sweeping claim in its complaint. In this Court's view, the pleading was sufficiently broad to cover both section 17(a)(2) and 17(a)(4). However, even if Judge Mahoney was incorrect in finding a violation of section 17(a)(2), the record amply supports Judge Mahoney's conclusion that Banister violated section 17(a)(4). Thus, the debt would be non-dischargeable regardless of the specific section violated by Banister.

As to the proof adduced at trial, the Court has carefully examined the record in this case and finds that Wachovia has more than met its burden of proving non-dischargeability. The proof of Wachovia consisted of the testimony of the Hatteras President

and the Hatteras National Sales Manager. Banister offered no witnesses, instead offering only several exhibits. The Court is, of course, guided by Federal Rule of Bankruptcy Procedure 810 which provides that the district court "shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge of the credibility of witnesses." Here, Judge Mahoney's factual findings are well supported by the record. In addition, the Court hereby adopts Judge Mahoney's reasoning and conclusions with respect to the violations of section 17(a). Accordingly, the Court rejects the claim that Wachovia failed to meet its burden of proof.

Establishment of Novation

When it was discovered that Northern Yachts no longer had possession of the boats in question, Wachovia took two security agreements from Banister and his wife. According to counsel for Banister, these agreements constituted a novation and serve as a complete bar to this action. While such an argument might appear reasonable on its face, there is no proof whatsoever that the notes given by the Banisters had any value. Thus, the Court agrees with Judge Mahoney that "[v]alueless security can not support a finding of a novation agreement." Memorandum-Decisioin and Order, No. 74-BK-463, slip op. at 14 (Bankr. N.D.N.Y. Feb.

11, 1980). See also In re Banister, No. 81-CV-1059, slip op. at 7-8 (N.D.N.Y. Nov. 1, 1982)(rejecting a similar claim by Banister in his first appeal).

Failure to Join the Real Party in Interest

As his final ground for appeal, Banister argues that Wachovia was not the real party in interest due to the execution of an assignment by Wachovia to Hatteras. See Fed. R. Civ. P. 25. The assignment by Wachovia took place after this action was commenced. Thus, under the plain language of Rule 25(c), Wachovia may continue as the real party in interest until the Court upon motion directs otherwise. Inasmuch as no motion for substitution was made, Banister's claim of error must be rejected. Accordingly, it is hereby

ORDERED, that the decision of the Bankruptcy Court dated February 11, 1980 is affirmed in all respects.

Dated: May 24, 1983
Syracuse, New York

Howard G. Munson
Howard G. Munson
Chief U.S. District Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In the Matter of

WILLIAM K. BANISTER

Bankrupt

In Bankruptcy

No. 74-BK-463

WACHOVIA BANK AND TRUST CO., N.A.

Plaintiff

Bruce Soden, Esq.
Of Counsel

- vs -

WILLIAM K. BANISTER

Defendant

Robert Shaad, Esq.
Of Counsel

Hon. Justin J. Mahoney, Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

Plaintiff, Wachovia Bank and Trust Co., N.A., "(Wachovia"), has filed a complaint against the bankrupt seeking to declare a debt non-dischargeable pursuant to Section 17 of the Bankruptcy Act. Defendant, William K. Banister, ("Banister"), filing an answer in general denial, has set forth therein several defenses. The witnesses who testified were Daniel Ralph Parker, President of the Hatteras Yacht Division of A.M.F. and Wesley William Dickman, former Director of Development and Sales Manager of Hatteras Yacht division of A.M.F. For reasons hereinafter discussed,

Wachovia is granted relief pursuant to Sections 17(a)(2) and 17(a)(4) of the Bankruptcy Act.

FACTUAL BACKGROUND

Banister was the President and sole stockholder of Northern Yachts, Inc. Northern Yachts dealt with the sale of high priced boats which included a type of boat known in the trade as a New Hatteras. The Hatteras line was the subject of a floor plan arrangement between Wachovia and Northern Yachts. In practice the floor planning contract programmed a financing procedure whereby Northern Yachts, prior to delivery of a boat by Hatteras, forwarded to Hatteras ten percent (10%) of the sales price, and Wachovia forwarded to Hatteras the other ninty percent (90%) or guarantee of such payment. The full amount owed to Wachovia by Northern Yachts was represented by a promissory note and a security instrument.

The controversy centers upon two specified boats: (1) a 58 foot Hatteras Yacht Fisherman, the subject of a promissory note in the sum of One Hundred Seventy-six Thousand One Hundred Two Dollars ($176,102), and a security agreement dated June 15, 1973, and (2) a 58 foot Hatteras Yacht Fisherman, the subject of a promissory note in the sum of One Hundred Forty-one Thousand Nine Hundred Forty-seven Dollars ($141,947), and a security instrument dated August 20, 1973. There is no question that the boats were delivered to Northern Yachts.

Banister contends that no proof exists to show that Northern Yachts received and spent the proceeds from the sale of the yachts subsquent to the June 15 and August 20 transactions.

It is the position of Banister that Northern Yachts had sold both boats prior to June 15 and August 20. Banister further contends that the boats in question were sold to specific customers and were exempt from the floor plan arrangement that dealt with boat inventory; i.e., the specific sales involved "customers' boats" and not "inventory boats." Additionally, Banister contends credit extended to the customers by reason of trade-ins made unrealistic any obligation of Northern Yachts to honor promissory notes which exceeded in amount the balance due and owing at the time of the actual transfer of the boats to the customers.

The issue is whether the proof permits a finding that Banister's conduct constituted a violation of Sections 17(a)(2) and 17(a)(4) of the Act.

FINDINGS OF FACT

1. That the complaint objecting to discharge was timely filed on August 26, 1974.

2. That Northern Yachts, the subject of an involuntary petition filed January 30, 1974, was adjudicated a bankrupt on April 11, 1974.

3. That Banister filed a voluntary petition in bankruptcy on March 22, 1974.

4. That Banister was the President and sole stockholder of Northern Yachts, Inc.

5. That under date of May 10, 1971, Wachovia and Northern Yachts, Inc. executed a floor plan arrangement for the financing of boat inventory. (Ex. 1)

6. That the procedure under the terms of the floor plan arrangement is outlined above in the factual background.

7. That under the floor planning procedure when Hatteras delivered a boat to Northern Yachts, Hatteras either had received full payment or guarantee of payment from the floor planning institution. (R. pg. 65)

8. That under the terms of the floor planning arrangement Northern Yachts was obligated to remit to Wachovia the proceeds for the sales of the Hatteras boats in satisfaction of the related promissory notes. (R. pgs. 64-70)

9. That the floor plan arrangement while beneficial to Hatteras also enabled Northern Yachts to develop an inventory from which they could display and sell boats. (R. pg. 61)

10. That during the period of the floor plan arrangement Northern Yachts executed in favor of Wachovia a promissory note in the sum of One Hundred Seventy-six Thousand One Hundred Two Dollars ($176,102) and a security agreement dated June 15, 1973, for the purchase from Hatteras of a 58 foot Hatteras Yacht Fisherman. (Ex. 6)

11. That during the period of the floor plan arrangement Northern Yachts executed in favor of Wachovia a promissory note in the sum of One Hundred Forty-one Thousand Nine Hundred Forty-seven Dollars ($141,947) and a security instrument dated August 20, 1973, for the purchase from Hatteras of a 53 foot Hatteras Yacht Fisherman. (Ex. 5)

12. That the 58 foot Hatteras Yacht Fisherman was sold by Hatteras to Northern Yachts in June, 1973. (R. pg. 77)

13. That the 58 foot Hatteras Yacht Fisherman was the subject of a promissory note and security instrument dated June 15, 1973. (Ex. 6)

14. That the 58 foot Hatteras Yacht Fisherman was the subject of a purchase order dated November 18, 1972, executed between Northern Yachts and a customer by the name of Gutchess. (Ex. 13)

15. That the 53 foot Hatteras Yacht Fisherman was the subject of a purchase order dated August 2, 1973, executed between Northern Yachts and a customer by the name of Rathanaus. (Ex. 11)

16. That sometime in September of 1973 Hatteras became aware that the 53 foot and 58 foot boats were not at Northern Yachts' place of business. (R. pgs. 99, 206, 207; Ex. 15)

17. That on October 12, 1973, Banister, while at his place of business, admitted to a representative of Hatteras that, "The boats weren't there." (R. pgs. 222, 252)

18. That on October 12, 1973, Banister admitted to a representative of Hatteras that the boats had been sold. (R. pg. 223)

19. That Banister's admissions establish that the amount owing by Northern Yachts to Wachovia for the boats in dispute totaled Three Hundred Eighteen Thousand Forty-nine Dollars ($318,049). (R. pgs. 235 - 243)

20. That on October 13, 1973, Northern Yachts executed a note in the amount of Two Hundred Twenty Thousand Dollars ($220,000) in favor of Wachovia which was collateralized by a security interest in ten specific boats, inventory, accounts receivables, etc. (R. pg. 172; Exs. A-7, A-8)

21. That on October 13, 1973, Banister and his wife signed a limited guaranty agreement for any and all obligations held by Northern Yachts. (Ex. A-14)

22. That in November, 1973, Northern Yachts executed a security interest and a mortgage interest in favor of Wachovia for an airplane and real property. (R. pgs. 173 - 180; Exs. A-10, A-11, A-12, A-13)

23. That the testimony indicated that the collateral represented by ten boats was worthless. (R. pgs. 142, 144, 170)

24. That there is no testimony indicating that any of the collateral supplied by Northern Yachts and Banister had any value.

25. That on December 17, 1974, Wachovia assigned to Hatteras any and all rights against Northern Yachts and Banister which arose out of the floor plan arrangement and which were applicable to the boat sales in dispute. (Ex. 9)

26. That during the month of December, 1973, Hatteras, by reason of a full recourse agreement with Wachovia, paid Wachovia the sum of Three Hundred Eighteen Thousand Forty-nine Dollars ($318,049) in satisfaction of the liability of Northern Yachts for the missing boats. (R. pgs. 105, 140, 142; Ex. 9)

27. That the boats were delivered as part of the floor planning agreement as it related to inventory boats; the sale of the boats to named customers were not transactions exempted, by any agreement or manner of execution, from the floor planning arrangement.

28. That the obligation of Northern Yachts to pay to Wachovia the full amount of the promissory notes from the proceeds of the boat sales was unaffected by any trade-in transaction.

29. That the proof establishes that on October 12, 1973, Banister acknowledged the indebtedness of Northern Yachts, Inc. in the amount of Three Hundred Eighteen Thousand Forty-nine Dollars ($318,049) for the missing boats. (R. pgs. 229, 223 - 225, 235 - 237)

30. That Banister did not rebut by any testimony the evidence offered by Wachovia in support of proof of violations of Section 17(a)(2) and 17(a)(4) of the Act.

RIGHT TO JURY TRIAL

Banister contends that the Court improperly denied his right to trial by jury. The record indicated that annexed to the defendant's answer is a timely demand for jury trial. Bankruptcy Act Section 17(c)(5); Rule 409(c) of Bankruptcy Rules. The demand does not specify any issue to be tried by jury but rather refers to issues raised by the complaint and answer.

The Court denied Banister's demand for jury trial by Order dated July 17, 1980. Previously, at a hearing held on December 6, 1974, Banister had represented that if the trial were held in Watertown his demand for jury trial would be waived. The Court, however,

at said hearing did not rule on the issue of a jury trial but, pending the resolution of other matters discussed, adjourned further proceedings without date. (December 6 Hearing, R. pgs. 12 - 13)

Subsequent to the December 6 hearing nothing further was accomplished toward resolution of the issues. This case speckled with excuses, delays, lack of cooperation, and equivocating correspondence remained in its stalled position on the calendar. The parties having failed to stipulate to a waiver of jury trial, as suggested at the December 6 hearing, or otherwise having made any progress, the Court issued the Order dated July 17, 1980, denying a jury trial.

Further delays ensuing and the calendar status of this case remaining unchanged after the July 17, 1980, Order, the Court, by letter dated October 20, 1980, directed the parties to appear in Albany for a trial on December 7, 1980. (Ex. A-5)

The Court agrees with the majority of judicial opinion that the question of dischargeability is an equitable one to be tried without a jury. *Katchen v. Landy,* 382 U.S. (1966); *Countryman, The New Dischargeability Law,* 45 Am. Bankr. L.J., 34 (1971); In re *Swope,* 466 F.2d 936 (7th Cir. 1972), cert. denied, 409 U.S. 1114 (1973); In re *Sneider,* 59 F.R.D. 391 (S.D.N.Y. 1973); In re *Hinchey,* 349 F. Supp. 116 (D.Ore. 1972); In re *Palfy,* 336 F.Supp. 1268 (N.D.Ohio 1972); *Transport Indem. Co. v. Hofer Truck Sales,* 339 F.Supp. 247 (D.Kan. 1971)(dictum); In re *Forth,* 2 Bankr. L. Rep. ¶64,327 (F.D.Mich. 1971); cf. In re *Law Research Service,* 2 Bankr. L. Service, 2 Bankr. L. Rep. ¶64,528 (S.D.N.Y. 1971).

The question of a jury trial on the issue of damages is controversial. But when damages are liquidated the need for a jury on such a question does not exist.

The use of a jury in this case for the purpose of determination of damages would be a waste of purpose and a useless expenditure of time. The record, as hereinafter discussed, conclusively establishes that Banister is indebted to Wachovia in the amount of Three Hundred Eighteen Thousand Forty-nine Dollars ($318,049).

Aside from the foregoing, the Bankruptcy Court exercising its equitable powers may dispense with a jury when strong and compelling reasons for so doing exist. The history of delays, equivocation, inactivity, lack of cooperation recorded in this case meet the test of strong and compelling reasons.

SECTION 17(a)(4)

Section 17(a)(4) excepts from discharge any debts which were created by a misappropriation of funds by a bankrupt while acting as an officer or in any fiduciary capacity. It is the contention of Wachovia that the documents supporting the floor plan arrangement created a trust relationship that obligated Banister to turn over to Wachovia the proceeds from the boat sales.

The Supreme Court limited the application of Section 17(a)(4) to "technical trusts, and not those which the law implies from contract." *Chapman v. Forsyth,* 2 How. 202, 208 (1844); *Crawford v. Burke,* 195 U.S. 176 (1904); *Hennequin v. Clews,* 111 U.S. 676 (1884); *Davis v. Aetna,* 293 U.S. 328 (1934). Nevertheless, cases decided since the above Supreme Court decisions have held that the misuse of funds in disregard of a known obligation thereto constitutes a fraud within the meaning of Section 17(a)(4) of the Act. In re *Bernard,* 87 F.2d, 705 2nd Cir. 1937), was such a case.

See In re *Tatum* v. *Leigh*, 136 Ga. 791 (1911). To the same effect, In re *Hammond*, 98 F.2d, 703 (2nd Cir. 1938).

In a strikingly similar case, *John P. McGuire Co.* v. *Herzog*, 421 F.2d, 419 (5th Cir. 1970), at page 422 the Court stated that the inapplicability of Section 17(a)(4) of the Act would render such section almost totally useless for the majority of debts arising from some sort of contractual arrangement. In the *Herzog* case, the bankrupt, President of the corporation, used funds obtained from the sale of floor planned merchandise to pay other debts of the corporation. The Court found the debtor guilty of a misappropriation in violation of Section 17(a)(4) of the Act. In the instant case the absence of any direct proof in explanation of the use of the boat sale proceeds does not justify any result contrary to what was reached in the *Herzog* case, supra.

SECTION 17(a)(2)

Section 17(a)(2) of the Act makes non-dischargeable any liability incurred by reason of the willful and malicious conversion of the property of another.

The standards for willful and malicious conversion were enunciated in *Tinker* v. *Calwell*, 193 U.S. 473, 485-487 (1904).

> [10] "In order to come within the meaning of Sec. 17a(2) as a judgment for a willful and malicious injury to person or property, it is not necessary that the cause of action be based upon special malice, so that without it the action could not be maintained . . . willful disregard of what one knows to be his duty, an act which is against good

morals and wrongful in and of itself, and which necessarily causes injury and is done intentionally, may be said to be done willfully and maliciously, so as to come within the exception."

Each factual situation must be examined to determine whether the elements of willfulness are present. The key factors are the intentional and willful disregard of a known duty.

By the terms of the security agreement, upon the default of Northern Yachts in payment, Wachovia was entitled to possession of the boats. The security agreements extended to Wachovia a continuing security interest in the Hatteras boats as collateral for Northern Yachts' liability on the promissory notes. At the time of the boat sales, Wachovia's security interest was valid; the effect of the sales was to remove collateral from the reach of Wachovia. In re *Duranti,* 5 BCD, 841 (W.D.Wis. 1979). Northern Yachts had the right to sell but not the right to dispose of the proceeds of sale in willful disregard of Wachovia's rights to the same. In re *Amador,* 596 F.2d, 428 (10th Cir. 1979).

The record permits the inference that the sale of the Hatteras boats by Northern Yachts without remitting the proceeds therefrom to Wachovia demonstrated a course of conduct that was wrong per se. Northern Yachts by its actions violated a known duty. No special malice toward Wachovia need exist. *Tinker v. Calwell,* supra.; *John P. McGuire & Co., Inc. v. Herzog,* 421 F.2d 419 (5th Cir. 1970; *Bennet v. T. Grant Co.,* 481 F.2d, 664 (4th Cir. 1973); In re *Hickman,* 2 BCD 449 (W.D.Mo. 1975); In re *Harding,* 2 BCD, 472 (W.D.Wis. 1976).

Banister contends that the pleadings do not permit a finding of a violation of Section 17(a)(2) and further asserts the claim of surprise. The Bankruptcy Court

is a Court of equity. *Young v. Higbee Co.*, 324 U.S. 204, 215 (1945); substantial right and justice, rather than technical form, control. *Jones v. Kendall*, 34 F.2d, 344, 347 (4th Cir. 1929). The Court granted the motion to conform the pleadings to the proof. (R. pg. 319) The question of whether Section 17(a)(2) or Section 17(a)(4) applies is a question of law. Regardless of the legal determination, the factual situation remained unchanged. Banister is not prejudiced by a legal determination made by the Court against an established set of facts that are not challenged by any direct testimony. Wachovia established a prima facie case of willful and malicious conversion that was not rebutted by Banister. In re *Amador*, supra. Further, the complaint satisfies the requirement of Rule 409(b) of the Bankruptcy Rules that the complaint set forth a statement of claim and demand for judgment.

The security extended to Wachovia, by agreements executed subsequent to the disappearance of the boat collateral, did not constitute a novation agreement. Wachovia's testimony established that the security embracing the boats was worthless. The bankruptcy schedules of both Northern Yachts and Banister indicate that the other collateral was either subject to foreclosure actions or encumbered by liens. Valueless security can not support a finding of a novation agreement. There is no proof that any equity existed in the collateral for the benefit of Wachovia.

Banister as President of a private corporation is an officer or fiduciary within the meaning of Section 17(a)(4) of the Act. In re *Bernard*, supra; In re *Hammond*, supra. A corporate officer is personally liable for conversion. It is immaterial that the collateral was owned by the corporation and that Banister received

no personal benefit. *Hinkle Iron v. Kohn*, 184 A.D. 181 aff'd. 229 N.Y. 179; *AMF, Inc. v. Algo Distributors*, 48 A.D.2d 352, 357 (2d.Dept. 1975).

CONCLUSIONS OF LAW

1. Wachovia is a proper party in interest. *F.R.C.P.*, 25(c).

2. Wachovia has established a prima facie case in support of a violation of Section 17(a)(2) of the Act. Bankruptcy Rule 407.

3. Wachovia has established a prima facie case in support of a violation of Section 17(a)(4) of the Act. Bankruptcy Rule 407.

Accordingly, the debt is found to be non-dischargeable and Wachovia is entitled to a judgment in the amount of Three Hundred Eighteen Thousand Forty-nine Dollars ($318,049), and, it is so

ORDERED.

Dated: February 11, 1982
Albany, New York

s/ Justin J. Mahoney
Bankruptcy Judge

Office - Supreme Court, U.S.
FILED
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ALEXANDER L. STEVAS.
CLERK

No. 84-393 (2)

IN THE

Supreme Court of the United States

October Term, 1984

WACHOVIA BANK AND TRUST COMPANY, N.A.,
Petitioner,

-vs.-

WILLIAM K. BANISTER,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Dated: October 29, 1984

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-vs.-

WILLIAM K. BANISTER,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondent, William K. Banister, respectfully prays that this Court deny the petition for a writ of certiorari to review the June 13, 1984 judgment of the United States Court of Appeals for the Second Circuit.

STATEMENT OF THE CASE

Respondent Banister was the president and sole stockholder of Northern Yachts, a corporation that had been a principal dealer since 1964 for custom yachts built by Hatteras Yachts. In 1971 Hatteras, in order to promote its new and expanded line of boats, proposed that Northern Yachts enter into a floor-plan financing arrangement with Wachovia which would enable Northern Yachts to acquire new inventory boats by paying 10% cash, with the bank financing the remaining 90%. That arrangement provided for a single constant floor plan agreement to cover all transactions and for an individual note/security agreement to be executed at the time of each transaction. The relevant parts of the floor plan agreement provided:

> "2. FINANCING TRANSACTIONS: We hereby agree as follows: (a) to notify you, prior to our receipt of any Inventory which we desire to be financed hereunder, of the facts with respect thereto and the amount and nature of the Advance desired; . . . (c) each Advance made by you shall constitute a new Advance by you to or for our account or benefit as of the time of such Advance; (d) any such Advance may, if you then elect, be paid to us, but *in every such case we agree that such Advance or the proceeds thereof will be used only in paying the purchase price of the Inventory being financed thereby, and for no other purpose;** (e) to repay to you the amount of each Advance with interest at the rate agreed in accordance with a promissory note therefor, which promissory note we agree to execute and deliver to you, concurrently with the Advance, in such form and with such terms as you may prescribe; (f) promptly upon or prior to the delivery to us of the Inventory financed by such Advance, *to execute and deliver*

*to you a trust receipt or receipts, or other security instrument, covering the Inventory financed by such Advance, in form and with terms prescribed by you;** (g) to pay promptly to you such amount of the cost of the Inventory as you may from time to time require; . . . (j) you shall have the right to collect all refunds payable to us by the manufacturer and/or distributor of any Inventory financed hereunder, and you shall apply the same in reduction of our obligations to you; and (k) *notwithstanding anything to the contrary contained in any trust receipt, promissory note or other instrument given by us to you hereunder, in the event any Inventory is sold, we will remit to you, the Unpaid Balance of the Cost Price of each item of Inventory promptly upon the sale of each such item.** Any security in Inventory given to you will secure the payment of all obligations owed by us now or hereafter." (*Emphasis added).

Each note/security agreement provided:

"_____days after date the undersigned promises to pay to Wachovia Bank and Trust Company, NA (hereinafter called Wachovia), or order, the sum of _____ Dollars for value received with interest . . .*if default is made in the payment of any amount due hereunder this note shall immediately become due and payable in full at the option of the holder hereof.**

* * * * *

"If the property described herein is held by the undersigned as 'Inventory,' the undersigned agrees to care for and hold such property only for the purpose of sale at retail and agrees further: . . .*(2) that in the event of the sale of any item of property or other disposition*

*thereof, the undersigned will pay promptly to Wachovia the amount due upon each item described.** (3) that the undersigned will keep any and all property, in whatever form same may be at any time or times, separate and capable of identification as the property of Wachovia and will surrender and account therefore to Wachovia forthwith upon demand and (4) that all provisions of any underlying FLOOR PLAN AGREEMENT between the undersigned and Wachovia, not inconsistent with anything contained herein, shall be considered as a part of this document as if fully set out herein . . . " (*Emphasis added).

Wachovia contends that the language of these agreements required Northern Yachts to hold whatever proceeds were received upon the sale of an inventory boat "in trust" for Wachovia[1] and to promptly remit such proceeds to Wachovia[2] Banister, while recognizing that the funds furnished by Wachovia must be used solely for the purpose of purchasing the inventory boat described in the security agreement and as such may be deemed to be trust funds, contends that there was no equivalent trust requirement with respect to the proceeds, and that instead the note/security agreements simply provide that Northern Yachts "will promptly repay to Wachovia the amount due upon each item described;" or put another way, the documents fix two maturity dates for the floor-plan loan; (1) a stated term after execution of the note/security agreement, or (2) upon sale of the item, whichever first occurs. The decision below concurs with respondent Banister's contention.

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[1] Petition page 5.

[2] Petition page 8.

The nature of the business and the course of dealings between the parties tend to establish that neither the parties nor the floor plan documents contemplated that the proceeds from the sale of inventory boats would be remitted "in kind" to either Hatteras or Wachovia. Firstly: the yachts involved take many months to build and outfit, and thus a dealer must anticipate his needs and place his orders months (even more than a year) ahead of delivery. After the order has been placed, the dealers frequently contract to sell that boat and actually take in a trade long before the inventory boat is ready for delivery; in fact the trade-in may be disposed of before the delivery date.[3] Secondly: in such transactions the dealer is often unable to pay off the note when the boat is sold because he still has the trade-in on hand, and he thereby becomes in arrears. Although both Hatteras and Wachovia were cognizant of such custom and practice, neither of them required the dealers to give any further security with respect to the trade, and neither they or the documents required the dealers to maintain a trust account or to segregate any of the proceeds received from the floor-planned boats. During the ten years of its dealings with Hatteras, Northern Yachts maintained but a single business account for all deposits and expenditures, and not once did either Wachovia or Hatteras inquire as to the manner in which Northern Yachts handled its monies.

There was no evidence that either Northern Yachts, or its president Banister, secreted any boats from or that either concealed or misrepresented any facts concerning the sale of the boats in question to Wachovia or Hatteras. Likewise there was no proof that Banister personally profited or benefited in any way from the proceeds of such boats.

---

[3] Both of the inventory boats involved in the instant case had been sold prior to their delivery date: Hatteras knew nine months before the delivery of the 58 foot yacht that it had been sold to Mr. Gutchess and that his trade in had been sold; and Hatteras likewise knew the 53 foot yacht was sold to Mr. Rothenhaus. Hatteras in fact delivered each of these boats directly to the customer, and thus knew that neither boat was ever in the custody of Northern Yachts.

SUMMARY OF ARGUMENT

This action was brought under the provisions of sections 17(a)(2) and (4) of the Bankruptcy Act of 1898, as amended, 11 U.S.C. §35 (1979), now replaced by section 523 of the Bankruptcy Code, 11 U.S.C. §523 (1982). The principal issue is whether a principal corporate officer who fails to disburse to a secured creditor proceeds from the sale of inventory in which the creditor has a secured interest incurs a debt that is non-dischargeable in the personal bankruptcy of that officer.

The determination of that issue involves interpretation of the financing transaction documents executed between petitioner bank ("Wachovia") and respondent Banister's corporation, Northern Yachts, Inc., for the floor-planning of large custom built yachts intended for retail sale. The decision below was in accordance with well established rules: that under section 17(a)(2) there can be no conversion where the financing documents failed to give Wachovia ownership or an immediate right of possession to the proceeds from the sale; and that under section 17(a)(4), unless such documents create an express obligation to hold in trust such proceeds, a corporate officer is entitled to a personal discharge where he has not personally benefited from the use of the monies.

There is no question of law involved that justifies the grant of a writ of certiorari.

ARGUMENT

Contrary to the statements in the petition that the language of the floor-plan documents

> "obligated Northern (Yachts) to hold whatever proceeds were received upon the sale of the Hatteras yacht, including cash, the trade in boat and its proceeds, *'in trust'* for Wachovia" [4]

and that the Floor Plan Agreement and Note and Security Agreement also

> "require the debtor (Northern Yachts) to promptly remit the proceeds of sale of a floor planned boat."[5]

those documents, even when read together, contain no such language or provisions.

It is axiomatic that any ambiguity arising from the language of the documents prepared and furnished by Wachovia must be resolved in favor of Northern Yachts and Banister. See:

> *4 Williston on Contracts*, § 621, p. 760 *et seq.* (New Third Edition);
>
> *Hurd v. Illinois Bell Tel. Co.*, 136 F.Supp. 125, 134, (ND Ill. 1955) aff'd 234 F2d 942 (CA7 1956), cert. den. 352 U.S. 977 1 L.Ed. 2d 329, 77 S.Ct. 352 (Case 1, 1957);
>
> *Mutual Life Ins. Co. v. Hurni Packing Co.*, 263 U.S. 167, 174 68 LEd 235, 44 S.Ct. 90 (1923).

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[4] Petition at page 5.

[5] Petition at page 8.

Likewise, the interpretation given by the parties themselves, either expressly or by implication from their course of dealing, will prevail. See:

> *4 Williston on Contracts*, § 623, p. 789 *et seq.* (New Third Edition);

Especially, the interpretation by the parties themselves after execution of the documents and before the controversy arose.

> *Pacific Portland Cement Co. v. Food Machine & Chemical Corp.*, 178 F.2d 541, 554 (CCA 9, 1950).

See also, *Insurance Company v. Dutcher*, 95 U.S. 269 (1877) stating at page 273:

> "There is no surer way to find out what the parties meant, than to see what they have done."

All of these considerations were briefed for and presented to the Second Circuit Court of Appeals. Nevertheless, the court reversed the decisions of the lower courts and held that the debt allegedly arising from diversion of proceeds of inventory sold pursuant to the floor plan agreement was dischargeable. The court below noted that Wachovia in drafting the forms of agreement could have, had it chosen to do so, selected "language that unmistakenly creates (in Northern Yachts) an obligation to hold proceeds separate and to remit *'specific money.'*" The court did not speculate on the reason Wachovia failed to do so.[4]

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[4] Appendix to petition at page A6.

THE COURT OF APPEALS CORRECTLY RULED THAT THERE WAS NO CONVERSION UNDER § 17(a)(2)

Although the financing documents provide that they are governed by the laws of North Carolina, the law of New York must be applied in determining whether Banister's conduct there constituted a state law tort.

> *O'Rourke v. Eastern Air Lines, Inc.*, 730 F.2d 842, 846-51 (2d Cir. 1984).

Wachovia on its claim of non-dischargeability under § 17(a)(2) must establish that the failure by Northern Yachts to pay for the two boats promptly upon their sale constituted a conversion. To do so, Wachovia was required to establish two things: (1) legal ownership and immediate right of possession to a specific identifiable thing (i.e., specific money), and (2) that Banister exercised unauthorized dominion over the thing in question.

> *AMF Inc. v. Algo Distributors, Ltd.*, 48 A.D.2d 352, 369 N.Y.S.2d 460 (2d Dept. 1975).

In *AMF, Inc.* the defendant was a distributor of products purchased from plaintiff under a security agreement which by its terms required it to account to plaintiff for *the proceeds* of any goods upon request. In finding that defendant's failure to do so constituted a conversion, the court distinguished *Independent Discount Corp v. Bressner*, 47 A.D.2d 765, 365 N.Y.S.2d 44 (2nd Dept. 1975), a case it had but recently decided, stating that "the crucial issue here is whether the plaintiff had an immediate right to possession of specific monies." By way of contrast the security agreement in *Independent Discount* provided that the debtor upon the sale was "to pay immediately all amounts due (plaintiff) with respect to the products financed" and the court found that there could be

no conversion because there was no specific fund from which the money owed to the creditor was to be paid.

The Second Circuit Court of Appeals found the instant case to be analogous to *Independent Discount* because there is no provision for holding the proceeds for Wachovia set forth in the documents; and that Northern Yachts' (and Banister's) obligation was merely to pay the balance owed upon the sale of the floor planned boats. The Court observed:[7]

> "The floor plan agreement obligated Northern Yachts to remit 'the Unpaid Balance of the Cost Price of each item of Inventory promptly upon the sale of each such item.' Similarly, the note and security agreement required Northern Yachts, in the event of sale, to 'pay promptly to Wachovia the amount due upon each item described.' This obligation to pay 'the balance' or 'the amount due' stands in marked contrast to the language of the acceleration clause, which gave Wachovia the right to declare immediately due all amounts owing if Northern Yachts 'fails to remit promptly any amounts received from any disposition of the property.' The bank's security agreement gave it a right of acceleration in the event that 'any amounts received' were not remitted, but imposed upon its debtor only an obligation to pay 'the amount'. The distinction is assuredly a technical one, but a bank, drafting a form agreement that it hopes will create the basis for claiming, in the event of nonpayment, the existence of a non-dischargeable debt, must select language that unmistakeably creates an obligation to hold proceeds separate and to remit *'specific money.'* "

---

[7] Appendix to petition at pp. A6 and A8.

Had the court below found a conversion, it would then have been incumbent upon it to further find that such conversion was willful and malicious on the part of Banister. See Mr. Justice Cardozo's decision in the leading case, *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 55 S.Ct. 151 (1934) in which he stated:

> "But a willful and malicious injury does not follow as of course from every act of conversion, without reference to the circumstance. There may be a conversion which is innocent or technical, an unauthorized assumption of dominion without willfulness or malice."

Mr. Justice Cardozo went on to hold that *"the discharge will prevail as against a showing of conversion without aggravated features."* There is here no evidence of any aggravating circumstances; and as hereinafter discussed, petitioner failed to offer any evidence upon trial that Banister had personally profited or benfitted in any manner from the use of the proceeds by his corporation.

Petitioner's Authorities Distinguished

Although the cases cited in the petition for the proposition that a conversion is committed "where one party exercises unauthorized assumption of the right of ownership or possession to the exclusion of a party who has a superior right to ownership or possession of the property in question"[1] are not in conflict with the decision below, none of them are in point. In fact two of the cases cite with approval *AMF Inc. v. Algo Distributors, Inc.* and *Independent Discount Corp. v. Bressner, supra.* See:

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[1] Petition at page 12.

Meese v. Miller, 79 A.D.2d 237, 242, 436 N.Y.S.2d 496, (4th Dept. 1981) and

First National Bank of Highland v. Merchant's Mutual Insurance Co., 89 Misc. 2d 771, 774, 392 N.Y.S.2d 896 (S.Ct. Ulster Co. 1977).

In *Meese* plaintiff ordered computer equipment and paid the supplier by a check which was deposited in defendant bank. The bank used the monies to pay off a commercial loan of the supplier, and when the plaintiff complained the bank falsely and fraudulently advised plaintiff that his equipment was on order. It was held that the complaint stated a cause of action for intentional fraud against the bank. In *First National Bank of Highland,* the defendant insurance carrier was held liable in conversion for its failure to pay to plaintiff bank collision insurance proceeds where it had constructive notice of the bank's lien on the insured auto. In *Employer's Fire Insurance Co. v. Cotten,* 245 N.Y. 102, 104 (1927) where the plaintiff sued an innocent purchaser of stolen property, who continued to hold it after learning of the theft, the court held that under the circumstances a demand was an unnecessary condition precedent to suit by plaintiff for conversion. In *Bunge Corp. v. Manufacturer's Hanover,* 37 A.D.2d 409, 414 325 N.Y.S.2d 983 (1st Dept. 1971) plaintiff exporter sold oils to a refiner requiring that payment for its warehouse receipts be made by cashier's check. The refiner (who later filed bankruptcy) obtained the warehouse receipts by exhibiting cashiers' checks for which he later presented substituted ordinary checks in payment to the exporter's cashier, subsequently returning the cashiers' checks for a refund. The court held that plaintiff failed to establish that defendant's check switching was unauthorized and that in the exercise of proper supervision should have discovered and put a stop to the scheme. In *Gandy v. Collins,* 214 N.Y. 293 (1915) Judge Cardoza held in an action for conversion that the mortgagee after default had a legal right to possession of the electric trains which had been pledged for a

loan. In *McIndoe v. Ithaca Loan Finance, Inc.* 24 A.D.2d 802, 263 N.Y.S.2d 849 (3rd Dept. 1965) the defendant, acting under a chattel mortgage properly filed more than four months before bankruptcy, replevied the mortgaged property after the bankruptcy proceeding was filed. It was held that the sheriff had acted properly because the mortgage was binding on the trustee, who thereafter had no claim to the property.

THE COURT OF APPEALS CORRECTLY RULED THAT THERE WAS NO MISAPPROPRIATION OF TRUST FUNDS WITHIN THE MEANING OF §17(a)(4)

Neither the documents or the testimony establish that either Northern Yachts or Banister were obligated to remit to Wachovia *the proceeds* or to hold the same in trust for Wachovia.[9] Lacking an *express* or *technical trust*, an implied trust must be distinguished.

> *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 55 S.Ct. 151, 152 (1934)
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> In *Davis* the debtor was a dealer in automobiles, who sold a car without the prior consent of the lender, although the terms of his loan required him to (1) obtain the prior written consent of the lender to the sale, and (2) "to make prompt remittance of a check." In construing the provisions of §17(a)(4) Mr. Justice Cardozo stated at page 154:

[9] See decision below, Appendix to petition at p. A9.

> "It is not enough that, by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee *ex maleficio.* He must have been a trustee before the wrong and without reference thereto. In the words of Blatchford, J.: 'The language would seen to apply only to a debt created by a person who was already a fiduciary when the debt was created.' "

The case held that there had been no misappropriation within the meaning of §17(a)(4).

The Case of *Matter of Whitlock,* 449 F. Supp.1383 (W.D. Mo. 1978) clearly demonstrates the distinction set forth in *Davis, supra.* In *Whitlock* the bankrupt was an officer and director of two subsidiary corporations as well as of the parent corporation which controlled both. One subsidiary financed the sale of mobile homes, while the other acted as the insurance agent for the sale of insurance on the same mobile homes. There was before the Court two sets of claims, the first for failure to pay mobile home dealers for the notes and security agreements which had been sold to banks; the second, a claim by an insurance company for failure to pay the premiums collected for it. The District Court held that Whitlock's indebtedness to the mobile home dealers, because of any personal participation by Whitlock in the defalcation, arose out a breach of an implied, as opposed to an express, trust; and that, in the absence of any personal gain by Whitlock, such indebtedness was dischargeable under §17(a)(4).

The fact that a corporate officer may be liable for corporate debts is not disputed, but such liability does not *ipso facto* exclude such liability from discharge under either subdivisions (2) or (4) of section 17(a) of the Bankruptcy Act. It is almost redundant to here repeat that the record is barren of any evidence that Banister profited or received any personal gain from the transactions. Accordingly, since the proceeds were not subject to an express trust, Banister's liability to Wachovia is a dischargeable debt.

Petitioner's Authorities Distinguished

The cases relied upon in the petition[10] to support the proposition that a corporate officer may not be personally discharged for a debt that arises from his misappropriation of proceeds from sales of collateral for which the corporation was liable are not in point. In each of the three cases, *John P. McGuire Co. v. Herzog,* 421 F.2d 419 (5th Cir. 1970) (floor planned furniture); *Matter of Penning,* 22 B.R.616 (E.D. Mich. 1982) (floor planned snowmobiles); and *Matter of Newman,* 2 BCD 894 (S.D.N.Y. 1976) (floor planned automobiles), the decisions indicate that the bankrupt corporate officer had sustained a personal gain or benefit from his misappropriations.

Likewise, in the cases cited as holding that the courts have not required the secured party to establish that the funds were misappropriated for the debtors personal use, as long as there is a showing of misappropriations, are not in point. *Matter of Folland* 10 B.R. 875 (D. Md. 1981) held that the vice president of a travel agency who participated in the travel agency's misuse of ticket funds, which by the agency agreement were required to be deposited in a specific account, would be held personally liable and nondischargeable regardless whether he had profited personally. Likewise, it was held in *Matter of Newman,* 2 BCD 285 (S.D.N.Y. 1976) that the president of an automobile dealership, which was obligated by its financial agreement to pay over the proceeds from each sale of an automobile, would be held liable for a nondischargeable debt arising from the sale of six automobiles, out of trust, regardless of whether he received any personal gain. In both of those cases the court found an express trust relationship.

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[10] Petition at page 13.

In *Kaufman v. Lederfine*, 49 F.Supp. 144 (S.D.N.Y. 1943) the trustee of a bankrupt corporation brought an action under the provisions of the N.Y. Stock Corporation Law §15 (now Bus. Corp. Law §510) containing an express limitation prohibiting the payment of dividends when a corporation is or would thereby become equitably insolvent. The District Court held that a judgment against an officer of the corporation, who had participated in the improper payment of such dividends, was nondischargeable under §17(a)(4), regardless of the fact that he had not personally benefited. The case is unique, involving as it does a direct violation by an officer of the duties imposed upon him as a corporate officer by the statutes of the State of New York, and is clearly distinguishable.

CONCLUSION

It is respectfully submitted that petitioner has wholly failed to sustain its burden of establishing under Rule 19 that there are special and important reasons why the writ should be granted. The issues here presented involve the interpretation of financing documents prepared by the petitioner, and as such not only are the documents but also the circumstances unique to the instant case. The decision rendered by the court below is in accord with the well established body of law relating to the dischargeability of debts under the former Bankruptcy Act of 1898, sections 17 (a)(2) and (4); therefore it creates no precedent an is unlikely to effect any substantial portion of the various multitude of the financial arrangements now existing.

The decision below did not involve an important question of federal law which has not been, but should be, settled by this court; nor has the Court of Appeals decided a federal question in a way to conflict with applicable decisions of this court or of another Court of Appeals on the same matter. The Court of Appeals correctly reversed the decision of the bankruptcy Judge and the District Court on the law and on the facts.

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Respectfully submitted,

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